

Letter of Findings: 04-20130125
Use Tax
For the Tax Years 2010 and 2011

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ISSUE

I. Use Tax – Non-Returnable Packaging Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-2; IC § 6-8.1-5-1; IC § 6-2.5-5-9; [45 IAC 2.2-5-16](#); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248 (Ind. 2003).

Taxpayer protests the assessment of use tax on certain items it considers subject to the non-returnable packaging exemption.

STATEMENT OF FACTS

Taxpayer is an Indiana company that provides value-added services to the automotive electronics industry. Specifically, Taxpayer programs air bag control modules and braking systems for the automotive and electronics industry.

The Indiana Department of Revenue ("Department") audited Taxpayer for sales and use tax compliance for the years 2010 and 2011. Pursuant to the audit, Taxpayer was assessed additional use tax and interest on certain general purchases as well as packaging supplies and materials for which Taxpayer had not paid sales tax at the point of purchase. For the year 2011, Taxpayer had remitted an estimated use tax liability for which the Department's audit gave Taxpayer credit.

Taxpayer protested the assessment of use tax on some, but not all, packaging materials and supplies. Taxpayer delineates the items Taxpayer is protesting in an attachment to a letter from Taxpayer dated March 15, 2013.

A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional information will be supplied as necessary.

I. Use Tax – Non-Returnable Packaging Exemption.

DISCUSSION

The Department assessed Taxpayer additional use tax on packaging materials and supplies it had purchased without paying sales tax at the point of purchase and without subsequently remitting use tax upon use of the items in Indiana. The Department's audit acknowledges that [45 IAC 2.2-5-16](#) provides an exemption from sales tax (and consequently use tax) for nonreturnable wrapping materials. The Department's audit, however, stipulates that to qualify for this exemption, the non-returnable containers must be sold in retail transaction of a retail merchant. The Department's audit refers to IC § 6-2.5-4-2(c) to state that a person is not making a retail transaction when the person acquires tangible personal property owned by another and provides industrial processing on that property. The Department found that Taxpayer is providing industrial processing (programming) on devices owned by other businesses and therefore Taxpayer is an industrial processor and not a retail merchant making a retail transaction. The Department's audit therefore determined that Taxpayer's purchase of the contested packaging items does not qualify for the non-returnable wrapping materials exemption.

As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. IC § 6-2.5-5 et seq. IC § 6-2.5-5-9 provides an exemption for non-returnable packaging.

When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the

exemption have been met. Indiana Dep't. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003). The Department will strictly construe the exemption statutes against the taxpayer claiming the exemption. Id.

The items that Taxpayer programs for its customers are highly sensitive to electrostatic discharge ("ESD") and moisture. Due to the sensitivity of the devices Taxpayer programs, Taxpayer must maintain a static free environment as well as carefully control the temperature of the devices. Taxpayer receives the devices from its customers in packaging that prevent electrostatic and moisture damage. This packaging once opened cannot be reused. As Taxpayer processes these devices it maintains strict electrostatic and moisture controls. Once programmed and inspected, the devices have to be repackaged in packaging similar to what had been received. Taxpayer states:

We ship the parts in the same ESD trays that they come to us in but have to use a new bag and ESD Rubber bands to hold the "brick" of trays together. This is then sealed into the Moisture/ESD bag, and then placed in a Box that is manufactured so that the Tray and Bag will fit in to it with very little room to shift. If there is too much room in the box the parts could move or get slammed up against the side of the box causing physical damage to the parts inside. Our customer then stores the parts on their shelf in the Bag/Box until they use them. . . . The main portion of the parts we are packaging go into the Air bag control modules and or braking systems, so keeping the parts free of damage either from ESD, Moisture or shipping is very important. The version of IC § 6-2.5-5-9 in effect for the years at issue in this protest states:

- (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for reuse as containers.
- (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in [IC 6-2.5-4-1](#) and if the returnable containers contain contents.
- (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
- (d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.
(Emphasis added).

In other words, the exemption applies to retail merchants acquiring the non-returnable packaging for selling the contents added by the retail merchant.

[45 IAC 2.2-5-16](#) elaborates:

- (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.
- (b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [\[45 IAC 2.2\]](#) provided an exemption for wrapping materials and containers.
- (c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:
 - (1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.
 - (2) Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.
 - (3) Returnable containers sold empty for refilling.
- (d) Application of general rule.
 - (1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
 - (A) The purchaser must add contents to the containers purchased; and
 - (B) The purchaser must sell the contents added.
 - (2) Returnable containers sold at retail with contents. To qualify for this exemption, the returnable containers must be:
 - (A) Sold in a taxable transaction of a retail merchant constituting selling at retail; and
 - (B) Billed as a separate charge by the retail merchant to his customer. If there is a separate charge for such containers, the sale of the container is exempt from tax under this regulation [\[45 IAC 2.2\]](#).
 - (3) Returnable containers sold empty. To qualify for this exemption the returnable container must be resold with the purpose of refilling. The sale of returnable containers to the original or first user thereof is taxable.
- (e) Definitions.
 - (1) Returnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term returnable container means containers customarily returned by the buyer of the contents for reuse as containers.
 - (2) Nonreturnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term "nonreturnable containers" means all containers which are not returnable containers.

(Emphasis added).

IC § 6-2.5-4-2, relied on by the Department's audit, states:

(a) A person is a retail merchant making a retail transaction when he is making wholesale sales.

(b) For purposes of this section, a person is making wholesale sales when he:

- (1) sells tangible personal property, other than capital assets or depreciable property, to a person who purchases the property for the purpose of reselling it without changing its form;
- (2) sells tangible personal property to a person who purchases the property for direct consumption as a material in the direct production of other tangible personal property produced by the person in his business of manufacturing, processing, refining, repairing, mining, agriculture, or horticulture;
- (3) sells tangible personal property to a person who purchases the property for incorporation as a material or integral part of tangible personal property produced by the person in his business of manufacturing, assembling, constructing, refining, or processing;
- (4) sells drugs, medical or dental preparations, or other similar materials to a person who purchases the materials for direct consumption in professional use by a physician, hospital, embalmer, funeral director, or tonsorior parlor;
- (5) sells tangible personal property to a person who purchases the property for direct consumption in his business of industrial cleaning; or
- (6) sells tangible personal property to a person who purchases the property for direct consumption in the person's business in the direct rendering of public utility service.

(c) Notwithstanding any provision of this article, a person is not making a retail transaction when he:

- (1) acquires tangible personal property owned by another person;
- (2) **provides industrial processing or servicing**, including enameling or plating, on the property; and
- (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

(Emphasis added).

Therefore, this statute specifically excludes industrial processors who acquire non-returnable packaging to transfer property back to its customers from the definition of retail merchants.

An "industrial processor," as defined in IC § 6-2.5-4-2, is one who: (1) acquires tangible personal property owned by another person; (2) provides industrial processing or servicing, including enameling or plating, on the property; and (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing. Taxpayer is clearly an industrial processor.

Based on all of the above, the Department's audit is correct; Taxpayer, as an industrial processor, does not qualify for the non-returnable packaging exemption for the years at issue under IC § 6-2.5-4-2 and IC § 6-2.5-5-9.

Taxpayer is notified, however, that IC § 6-2.5-5-9(d) was amended under P.L. 137-2012, Sec. 48, effective July 1, 2012, to read as follows:

(d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for:

- (1) selling the contents that the person adds; or
- (2) shipping or delivering tangible personal property that:
 - (A) is owned by another person;
 - (B) is processed or serviced for the owner; and
 - (C) will be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in the owner's business of manufacturing, assembling, constructing, refining, or processing.

(Emphasis added).

Therefore, effective July 1, 2012 (and presuming no further changes in the law), Taxpayer's purchase of items used similarly to the protested items will be subject to exemption under an amended IC § 6-2.5-5-9(d).

FINDING

Taxpayer's protest is respectfully denied.

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An [html](#) version of this document.